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The Manufacturers Hanover

Financial Digest

Weekly Commentary, Selected Financial Data, and Business Indicators

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Housing Remains Strong . . .

With one of the twin locomotives of the economy, automobiles, chugging ahead at high sales and production levels, attention is now focusing on whether the other one, housing, is also speeding up the track—or stalled on a siding. The week's release of the housing starts figures for September—whether the number is good or bad—will only add fuel to any such discussion.

One way of determining how housing might perform for the rest of 1985 is to look at how it has done so far this year. For the first eight months, housing starts averaged a seasonally adjusted annual rate of 1.76 million units, or about 4.3 percent below the 1.84 million unit rate of the comparable period of 1984. At the end of last year, however, housing starts shrank significantly. Thus if home construction holds steady during the remainder of this year, 1985 could displace 1984 as the best year for the housing industry since 1978—when over two million houses were started. And with permits, an indicator of future construction, up 13.7 percent in August over a year ago, the coming months could well be strong.

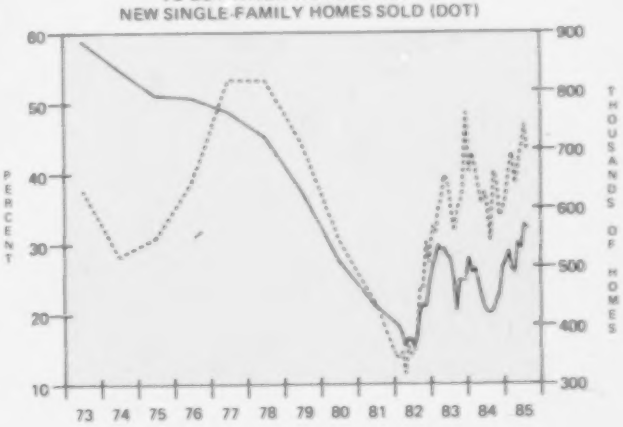
One of the biggest surprises in homebuilding has been the resurgence of construction in the Northeast. Starts in the New England and Middle Atlantic states for the January-August period were up 25 percent from the comparable months of 1984. In contrast, starts in the West were up only 4.4 percent, and in the South and Midwest, they dropped 14.1 percent and 7.2 percent, respectively. A major reason for the Northeast's present strength is that the transition from a traditional manufacturing economy to services and high-technology oriented industries seems to be over. This has created large areas of economic stability and prosperity.

Moreover, what support there has been this year for the slumping apartment-building sector has come from the Northeast, particularly in the metropolitan areas of Boston and New York City. Construction of buildings with five or more units doubled in the Northeast in the first two quarters of 1985 compared with the same period last year. For the rest of the nation, apartment starts fell 8.5 percent.

. . . Supported By Improved Affordability . . .

With the high cost of credit, builders will only start construction if they are sure of a market for their completed houses. Here the news is good. Although new single-family home sales did drop 5.6 percent from July to August, this came after an upward revision in July's figures, rather than a reversal of housing's prospects. In fact, home sales have averaged a rate of more than 700,000 for the last three months—the highest for any three-month period since the summer of 1979.

PERCENT OF HOUSEHOLDS THAT CAN AFFORD TO BUY A NEW HOME (LINE) VS. NEW SINGLE-FAMILY HOMES SOLD (DOT)



Relative stability in home prices coupled with the recent drop in mortgage rates and continuing growth in personal incomes have made homes more affordable for more people. As the chart shows, the percentage of households that can afford to buy a new home has bounced up from its 1982 lows, helping sales rise as well. Using the rule of thumb that only 25 percent of a household's gross income should go to housing expenses, only 17 percent of all households could afford a home in April 1982, when the median price was $70,200 and conventional mortgages had a fixed interest rate of 17.5 percent. Now that fixed rates have fallen to little more than 12 percent and home price increases have slowed, about 37 percent of potential homebuyers

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can service a mortgage. Moreover, if adjustable-rate mortgages with the going interest rate of about 10.5 percent are included, the percent bumps up to 42 percent. Another result of the increased affordability is that more people are planning to buy homes. In a Conference Board survey of consumers in September, 3.5 percent said they intend to buy a house within the next six months, up from 2.9 percent at the end of last year.

. . . And Leaner Inventories

The high sales rates of the summer reduced the supply of unsold new homes to 5.8 months. This level is more manageable than at the end of 1984 when it was seven months—not to mention during late 1981, when there was a nine to 11 months' supply of unsold homes. Further, the low inventory should support a good fourth quarter for housing, since builders can worry less about oversupply.

The market for existing homes has also been healthy. Sales in August were at a seasonally adjusted annual rate of 3.43 million units, the highest rate since November 1979. Once again, affordability is the catalyst. The National Association of Realtors' Affordability Index—which compares the median family income as a percent of the income needed to purchase a median-priced existing home—rose to 94.8, the highest level in six years. This means that a family with the median income would have to use 26.4 percent of their gross earnings to service the mortgage on a median-priced home. Although this is still higher than the 25 percent standard, it is much

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 10/9/85	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	177.986	– .060	+18.528
Loans to Depository Inst.	1.349	– .091	– 4.808
Float	.817	– .455	+ .267
Total Reserve Bank Credit	193.293	– .291	+15.010
Treasury Deposits with Federal Reserve Banks	2.909	– .763	– 1.733
Currency in Circulation	188.764	+ 1.276	+11.739
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	125.778	– .143	+ 8.869
	10/9/85		
Member Bank Reserves:			
Total Reserves Held	43.688	+ .599	+ 5.612
Excess (Deficiency)	.826	+ .156	– .078
Net Free Reserves	.058	– .097	+ .172

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1 (6/30/85)	615.0	+ 13.5‡	+ 11.0‡
M2 (September '85)	2,528.4	+ 9.0	+ 9.5
M3 (September '85)	3,163.3	+ 7.8	+ 9.0
Domestic Nonfinancial Debt (2nd Q'85)	6,317.3	+ 12.2	+ 13.6

†Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 10/11/85	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	7.21%	7.36%	7.47%
* Federal Agencies	8.10	8.45	9.10
* Municipal Notes—High Grade (46% Taxable Equivalent)	9.07	9.26	9.63
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.80	8.03	8.25

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	7.80%	Nov.	7.82%
15- 29 days	7.80	Dec.	7.82
30- 59 days	7.80	Jan.	7.82
60- 89 days	7.80	Feb.	7.82
90-179 days	7.85	Mar.	7.82
180-239 days	7.85	Apr.	7.82
240-270 days	7.85		

‡Industrial Paper—Prime			
30- 89 days	7.80%	†Federal Funds Effective Rate	8.26%
90-120 days	7.85		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'85	$ 3,853	$ 3,811	$ 3,645
Gross National Product (1972 Dollars)*	2nd Q'85	$ 1,671	$ 1,664	$ 1,639
Percent Change, Annual Rate	2nd Q'85	1.9	0.3	7.1
Change in Consumer Prices*	Aug '85	2.4%	2.4%	4.8%
Change in Producer Prices*	Sep '85n	– 7.2%	– 3.6%	0.0%
Civilian Employment (Thousands of Persons)†	Sep '85	107,544	107,172	105,394
Unemployment as % of Civilian Labor Force†	Sep '85	7.1%	7.0%	7.4%
Personal Income*	Aug '85	$ 3,199	$ 3,190	$ 3,046
Leading Indicators Composite Index (1967=100)†	Aug '85	170.1	169.0	164.4
Industrial Production Index (1977=100) †	Aug '85	124.8	124.4	123.5
Net Change in Consumer Installment Credit †	Aug '85n	$ 6.31	$ 6.25	$ 6.02
U.S. Merchandise Trade Balance †	Aug '85	–$ 9.90	–$ 10.51	–$ 10.09
Plant and Equipment Expenditures*	4th Q'85	$387.40(a)	$388.54(a)	$368.29
Private Housing Starts (Thousands of Units)*	Aug '85	1,749	1,647	1,590
New Construction Expenditures*	Aug '85	$ 344.0	$ 340.2	$ 321.2
Total Business Inventories †	Jul '85	$ 579.8	$ 579.7	$ 557.2
Total Business Sales †	Jul '85	$ 422.2	$ 418.4	$ 412.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

lower than the 30 percent needed a year ago, and the peak of 36 percent posted in 1981. And while the resale market does not contribute directly to the home construction industry, it does help housing-dependent manufacturers by raising demand for such items as furniture and appliances.

For those who have already taken the home-ownership plunge, home improvements have become an important activity which has also helped to push our economy. Real investment on additions and alterations of residential structures grew at a 12 percent annual rate in the second quarter, after rising at a 23 percent annual rate in the first quarter of this year. In contrast, the economy as a whole expanded at annual rates of only 0.3 and 1.9 percent in the first and second quarters.

Nonetheless, the track ahead for the housing industry is not entirely smooth. Mortgage delinquency rates are still high, causing many mortgage lenders to tighten up on income and downpayment requirements. More important, the potential impact of the proposed Federal tax reforms has caused many builders and buyers to take a "wait and see" position. The proposed changes in the tax codes would disallow certain deductions for home-ownership, especially vacation and second homes. They would also eliminate tax-exempt bonds issued by states or municipalities to provide funds for low-cost mortgages. The National Association of Realtors estimates that such tax changes would add $1,100 to $2,400 to the annual cost of home-ownership, again barring a sizable segment of our population from buying. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (9/25/85)	156,182	+ 1,787	– 2,126
New York City (10/2/85)	32,945	+ 363	– 1,923
Commercial Paper (10/2/85)	279,123	+ 694	+50,865

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/25/85)	664,457	– 1,839	+ 51,811
New York City (10/2/85)	60,547	+ 97	– 4,395

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/25/85)	687,042	– 2,293	+ 58,510
New York City (10/2/85)	154,664	+ 3,190	+ 13,794

Financial Markets

	Friday 10/11/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.45%	+ .28	– 2.85
180-Day Bills†	7.72	+ .11	– 2.98
Longest Bills†	8.04	+ .08	– 2.96
Recent Issues:			
9s 9/30/87	8.94	+ .10	
9⅝s 6/30/89	9.63	+ .11	
10¼s 8/15/95	10.33	– .01	
10⅝s 8/15/15	10.60	– .02	
Municipals:			
Bond Buyer–20 Bond Index* (10/10/85)	9.25%	– .08	– 1.11
Blue List Total ($ Million)	$1,707	–$ 156	+ $ 76
30-Day Visible Supply ($ Million)	$4,583	+$1,835	+ $1,188
Total	$6,290	+$1,679	+ $1,264
Corporates:			
Moody's Aa Composite (10/10/85)	11.51%	– .01	– 1.74
30-Day Visible Supply ($ Million)	$2,435	+$1,090	+ $1,587
Stocks:			
Dow-Jones Averages:			
Industrials	1,339.94	+ 11.20	+ 149.24
Transportation	647.47	+ .23	+ 130.07
Utilities	154.06	– 1.08	+ 13.33
65 Stocks	543.11	+ 2.15	+ 72.05
Standard and Poor's 500 Stocks	184.28	+ 1.06	+ 20.10
N.Y.S.E. Composite Index	106.56	+ .62	+ 11.77
N.Y.S.E. Avg. Daily Vol. for Week (000's)	96,046	–26,050	+ 16,636

* 46% Taxable equivalent 17.13%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 10/11/85	Week Ago
Overnight	7.81%	7.75%
1 month	7.94	7.94
3 month	8.13	8.00
6 month	8.25	8.13
1 year	8.63	8.50
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	10.12%	10.08%
Long Term (7 to 15 yrs.)	10.62	10.60

FOREIGN EXCHANGE SPOT RATES

New York Opening (10/11/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01854	53.9300
Canada	.7298	1.3703
Denmark	.1040	9.6150
France	.1235	8.1000
Germany	.3766	2.6550
Italy	.0005577	1793.00
Japan	.004639	215.55
Mexico	.002500	400.00
Netherlands	.3337	2.9965
Switzerland	.4581	2.1830
U.K.	1.4120	.7082

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